

ORIGINAL

MEMORANDUM

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TO: Docket Control

FROM: Ernest G. Johnson  
Director  
Utilities Division

EA for EGJ  
AZ CORP COMMUNICATIONS  
DOCKET CONTROL

DATE: June 5, 2009

RE: STAFF REPORT FOR LEVEL 3 COMMUNICATIONS, LLC, BROADWING COMMUNICATIONS, LLC, AND WILTEL COMMUNICATIONS LLC APPLICATION FOR A LIMITED WAIVER OF THE PUBLIC UTILITY HOLDING COMPANIES AND AFFILIATED INTEREST RULES (A.A.C. R14-2-801 ET SEQ.) AND APPROVAL OF ENCUMBRANCE OF ASSETS (DOCKET NOS. T-03654A-09-0174, T-04176A-09-0174 AND T-03708A-09-0174)

Attached is the Staff Report for Level 3 Communications, LLC; Broadwing Communications, LLC; and WilTel Communications, LLC ("Applicants") application for a limited waiver of the public utility holding companies and affiliated interest rules (A.A.C. R14-2-801 et seq.) and approval of encumbrance of assets. Staff recommends conditional approval of the Applicants' alternate request for authorization to guarantee the "Credit Agreement" and to encumber their assets.

Any party or interested member of the public who desires may file comments on the Staff Report with the Commission's Docket Control by 4:00 p.m. on or before June 19, 2009.

EGJ:BCA:red

Originator: Brendan C. Aladi

Arizona Corporation Commission

**DOCKETED**

JUN - 5 2009

DOCKETED BY	
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Docket No. T-03654A-09-0174 et al

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**STAFF REPORT  
UTILITIES DIVISION  
ARIZONA CORPORATION COMMISSION**

**LEVEL 3 COMMUNICATIONS, LLC; BROADWING COMMUNICATUIONS, LLC;  
AND WITEL COMMUNICATIONS, LLC  
DOCKET NOS. T-03654A-09-0174, T-04176A-09-0174 AND T-03708A-09-0174**

**APPLICATION FOR A REQUEST FOR LIMITED WAIVER OF THE PUBLIC  
UTILITY HOLDING COMPANIES AND AFFILIATED INTEREST RULES AND  
APPROVAL OF ENCUMBRANCE OF ASSETS**

**JUNE 5, 2009**

## STAFF ACKNOWLEDGMENT

The Staff Report for Level 3 Communications, LLC; Broadwing Communications, LLC; and WilTel Communications, LLC (Docket Nos. T-03654A-09-0174, T-04176A-09-0174 and T-03708A-09-0174) is the responsibility of the Staff member listed below. Brendan C. Aladi is responsible for the review and financial analysis of the Company's application.

A handwritten signature in black ink, appearing to read "Brendan C. Aladi". The signature is stylized with a large initial "B" and a long, sweeping underline.

BRENDAN C. ALADI  
PUBLIC UTILITIES ANALYST III

**EXECUTIVE SUMMARY**  
**LEVEL 3 COMMUNICATIONS, LLC; BROADWING COMMUNICATIONS, LLC;**  
**AND WILTEL COMMUNICATIONS, LLC**  
**DOCKET NOS. T-03654A-09-0174, T-04176A-09-0174 AND T-03708A-09-0174**

On April 6, 2009, Level 3 Communications, LLC ("Level 3"), Broadwing Communications, LLC ("Broadwing"), and WilTel Communications, LLC ("WilTel") (collectively "Applicants") filed a joint application with the Arizona Corporation Commission ("Commission"), for a limited waiver of the Public Utility Holding Companies and Affiliated Interest rules and approval of encumbrance of assets, or in the alternative, authorization to guarantee the "Credit Agreement" and to encumber their assets.

Level 3, a wholly owned subsidiary of Level 3 Financing, Inc. ("Financing"), is a Delaware Limited Liability Company headquartered in Broomfield, Colorado. Broadwing and WilTel are subsidiaries of Level 3.

In Arizona, the Applicants are authorized to provide facilities-based and resold local exchange, toll, access services, and intrastate interexchange telecommunication services.

Decision No. 69580 authorized the Applicants to pledge their Arizona assets as security for (a) \$1 billion in new notes, comprised of 8.75 percent fixed interest rate notes with a maturity date of 2017 and variable rate interest notes with maturity dates in 2015, and (b) a \$1.4 billion Credit Agreement with maturity in 2014 (together "2007 Financing"). The Applicants' current application pertains to their anticipated modification to the Credit Agreement that would increase potential long-term borrowing capacity by \$500 million from \$1.4 billion to \$1.9 billion. The amount of this borrowing capacity that is available is dependent on the operating income of Financing and its subsidiaries ("accordion provision"). The Applicants have received a commitment from the lenders to obtain loans for \$280 million of the potential \$500 million incremental capacity. The Applicants assert that the proceeds of the incremental borrowing under the "Credit Agreement" will be advanced to Level 3 for an intercompany demand note. The funds will be used for working capital and general corporate purposes, including debt repurchases.

The Applicants assert that their support for Financing's exercise of the accordion provision of the Credit Agreement will not result in a change in Applicants' management or in its day-to-day operations; nor will it adversely affect Applicants operations in Arizona. The Applicants note that all the jurisdictional assets, capital stock and/or membership interests were pledged in the 2007 Financing and that no new jurisdictional assets are pledged in this application. The Applicants further state that Arizona jurisdictional assets will not be encumbered as collateral with respect to the incremental borrowing until state regulatory approval is received.

Staff concludes that the approval of the Applicants to act as co-borrowers or guarantors of Level 3 Financing, Inc.'s debt and/or to pledge their assets in connection with the "Credit Agreement" would not impair the availability of service to customers since the Applicants

provide competitive services that are available from alternate service providers. However, customers may still have exposure to losses to the extent they have prepaid for service or made deposits. Accordingly, any authorization for encumbrance should provide customer protection for prepayments and deposits.

Staff recommends denial of the Applicants' request for a limited waiver of the Public Utility Holding Companies and Affiliated Interests rules.

Staff further recommends approval the Applicants' alternative request for authorization to guarantee the "Credit Agreement" that provides up to \$500 million of additional long-term borrowing capacity and to secure the debt by liens on the Applicants' assets and/or capital stock subject to the condition that all Arizona customer deposits and prepayments, if any, be excluded from encumbrance, or in the alternative, that all Arizona customer deposits and prepayments, if any, be secured by a bond or irrevocable sight draft letter of credit which is not included in the pledged collateral.

Staff further recommends that if the Applicants exercise the option of procuring a performance bond or irrevocable sight draft letter of credit to protect Arizona customer deposits and prepayments, that they file the performance bond with the Commission's business office, within 60 days of the effective date of the Decision in this proceeding.

Staff further recommends authorizing the Applicants to engage in any transaction and to execute any documents necessary to effectuate the authorizations granted.

Staff further recommends that the Applicants file, with Docket Control within 60 days of the execution of any financing transaction authorized herein, documentation stating that the transaction has been executed and the date it was executed.

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## INTRODUCTION

On April 6, 2009, Level 3 Communications, LLC (“Level 3”), Broadwing Communications, LLC (“Broadwing”), and WilTel Communications, LLC (“WilTel”) (collectively “Applicants” or “Company”) filed a joint application with the Arizona Corporation Commission (“Commission”), for a limited waiver of the Public Utility Holding Companies and Affiliated Interest rules and approval of encumbrance of assets, or in the alternative, authorization to guarantee the “Credit Agreement” and to encumber their assets.<sup>1</sup>

## PUBLIC NOTICE

On May 7, 2009, the Company provided Staff an Affidavit of Publication verifying public notice of its financing application. The Company published notice of its financing application in *The Arizona Republic* on April 24, 2009. *The Arizona Republic* is a newspaper of general circulation in Maricopa County. The Affidavit of Publication is attached along with a copy of the notice.

## BACKGROUND

Level 3 is a Delaware limited liability company certificated by the Arizona Corporation Commission to provide facilities-based and resold local exchange, toll and access services pursuant to Decision No. 61737, dated June 4, 1999. Level 3 is a wholly owned subsidiary of Level 3 Financing, Inc. (“Financing”), which in turn is wholly owned by Level 3 Communications, Inc. (“Parent”).

Broadwing, a subsidiary of Level 3, is certificated to provide telecommunication services in all fifty states, including the District of Columbia. Also, Broadwing is authorized to provide local exchange telecommunication services in 19 states and the District of Columbia. Broadwing reports that the Federal Communication Commission through Section 214 authorizes it to provide interstate and international telecommunications services. In Arizona, Broadwing is certificated to provide resold and facilities-based intrastate interexchange telecommunications services.<sup>2</sup>

WilTel is also a subsidiary of Level 3. WilTel is certificated to provide resold and facilities-based competitive local exchange and inter-exchange services in Arizona pursuant to Decision No. 62025, dated November 2, 1999.

Class “A” utilities are subject to the Public Utility Holding Companies and Affiliated Interest Rules (A.A.C. R12-2-801 to R12-2-806). These rules seek to (a) prevent commingling of utility and non-utility funds; (b) prohibit cross-subsidization on non-utility activities by utility

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<sup>1</sup> Level 3 and WilTel are Class “A” utilities subject to the Affiliated Interest Rules (A.A.C. R12-2-801 to R12-2-806). Broadwing is not a Class “A” utility and only seeks approval pursuant to A.R.S. § 40-285 in relation to the encumbrance of assets.

<sup>2</sup> Decision No. 66105, dated July 25, 2003,



ratepayers; (c) prevent negative impact of non-utility activities on a utility's financial credit; and (d) ensure that the utility and its affiliates provide the Commission with the information necessary to "carry out its regulatory responsibilities."<sup>3</sup>

## **PURPOSE AND DESCRIPTION OF PROPOSED FINANCING**

Decision No. 69580<sup>4</sup> authorized the Applicants to pledge their Arizona assets as security for (a) \$1 billion in new notes, comprised of 8.75 percent fixed interest rate notes with a maturity date of 2017 and variable rate interest notes with maturity dates in 2015, and (b) a \$1.4 billion Credit Agreement with maturity in 2014 ("2007 Financing"). The Applicants' current application pertains to their anticipated modification to the Credit Agreement that would increase potential long-term borrowing capacity by \$500 million from \$1.4 billion to \$1.9 billion. The amount of this borrowing capacity that is available is dependent on the operating income of Financing and its subsidiaries ("accordion provision"). The Applicants have received a commitment from the lenders to obtain loans for \$280 million<sup>5</sup> of the potential \$500 million incremental capacity. The Applicants assert that the proceeds of the incremental borrowing under the Credit Agreement will be advanced to Level 3 for an intercompany demand note. The funds will be used for working capital and general corporate purposes, including debt repurchases.

## **COMPLIANCE**

There are no compliance issues with the Applicants.

## **FINANCIAL ANALYSIS**

The Applicants request authorization to pledge assets as security for the Credit Agreement. A.R.S. § 40-285 requires public service corporations to obtain Commission authorization to encumber certain utility assets. The statute serves to protect captive customers from a utility's act to dispose of any of its assets that are necessary for the provision of service, thus, it serves to preempt any service impairment due to disposal of assets essential for providing service. Further, A.A.C. R14-2-804(B) provides that a utility will not, without Commission approval, obtain a financial interest in any affiliate not regulated by the Commission, or guarantee, or assume the liabilities of such affiliate. In this instance, a pledge of the Applicants assets should not impair the availability of service to customers since the Applicants provide competitive services that are available from alternate services providers. However, customers may still have exposure to losses to the extent they have prepaid for services or made deposits. Therefore, any authorization for encumbrance should provide customers protection for prepayments and deposits.

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<sup>3</sup> Decision No. 56618.

<sup>4</sup> Dated May 21, 2007.

<sup>5</sup> On May 13, 2009, the Applicants filed a supplement to their initial application noting an increase in the lenders commitment from \$220 million to \$280 million.

A.A.C. R14-2-804(C) requires the Commission to review transactions subject to A.A.C. R14-2-804(B) to determine if those transactions would impair the financial status of the public utility, otherwise prevent it from attracting capital at fair and reasonable terms, or impair the ability of the public utility to provide safe, reasonable and adequate service. The proposed transactions would provide additional capital to the Applicants. The Applicants assert that the transactions will enable them to bring services to new markets, and allow more consumers to benefit from its competitive services more quickly and efficiently. The Applicants also provide competitive services that are available from alternate services providers. Accordingly, the transactions in this proceeding satisfactorily meet the conditions subject to review.

In the instance of utilities providing service to captive customers in a non-competitive circumstance, A.R.S. § 40-301 prohibits authorization of debt unless the Commission finds that the debt issuance is within the corporate powers of the applicant, is compatible with the public interest, with sound financial practices and with the proper performance by the applicant of service as a public service corporation and will not impair its ability to perform that service. However, pursuant to A.R.S. § 40-301(D), foreign public service corporations providing communication service whose facilities are also used in interstate commerce are exempt from application of the statute. Staff finds that the Applicants satisfy the criteria for exemption from A.R.S. § 40-301 for the transactions contemplated in the application (Credit Agreement and demand note).

## **STAFF CONCLUSIONS AND RECOMMENDATIONS**

Staff concludes that the approval of the Applicants to act as co-borrowers or guarantors of Level 3 Financing, Inc.'s debt and/or to pledge their assets in connection with the "Credit Agreement" would not impair the availability of service to customers since the Applicants provide competitive services that are available from alternate service providers. However, customers may still have exposure to losses to the extent they have prepaid for service or made deposits. Accordingly, any authorization for encumbrance should provide customer protection for prepayments and deposits.

Staff recommends denial of the Applicants' request for a limited waiver of the Public Utility Holding Companies and Affiliated Interests rules.

Staff further recommends approval the Applicants' alternative request for authorization to guarantee the "Credit Agreement" that provides up to \$500 million of additional long-term borrowing capacity and to secure the debt by liens on the Applicants' assets and/or capital stock subject to the condition that all Arizona customer deposits and prepayments, if any, be excluded from encumbrance, or in the alternative, that all Arizona customer deposits and prepayments, if any, be secured by a bond or irrevocable sight draft letter of credit which is not included in the pledged collateral.

Staff further recommends that if the Applicants exercise the option of procuring a performance bond or irrevocable sight draft letter of credit to protect Arizona customer deposits

a prepayments, that they file the performance bond with the Commission's business office, within 60 days of the effective date of the Decision in this proceeding.

Staff further recommends authorizing the Applicants to engage in any transaction and to execute any documents necessary to effectuate the authorizations granted.

Staff further recommends that the Applicants file, with Docket Control within 60 days of the execution of any financing transaction authorized herein, documentation stating that the transaction has been executed and the date it was executed.

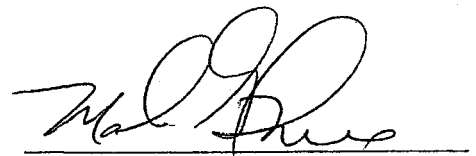
# THE ARIZONA REPUBLIC

STATE OF ARIZONA }  
COUNTY OF MARICOPA } SS.

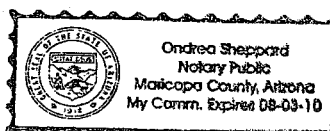
Mark Gilmore, being first duly sworn, upon oath deposes and says: That he is a legal advertising representative of the Arizona Business Gazette, a newspaper of general circulation in the county of Maricopa, State of Arizona, published at Phoenix, Arizona, by Phoenix Newspapers Inc., which also publishes The Arizona Republic, and that the copy hereto attached is a true copy of the advertisement published in the said paper on the dates as indicated.

The Arizona Republic

4/24/2009



Sworn to before me this  
24<sup>TH</sup> day of  
April A.D. 2009




Notary Public

In the Matter of the Application of Level 3 Communications, LLC, Broadwing Communications, LLC, and WITel Communications, LLC for a Limited Waiver of the Public Utility Holding Companies and Affiliated Interests Rules (A.A.C. R12-2-801 et seq.) and Approval of Encumbrance of Assets. Docket Nos. T-03554A-09-0174, T-04176A-09-0174, T-03708A-09-0174.

Level 3 Communications, LLC, Broadwing Communications, LLC, and WITel Communications, LLC (collectively the "Applicants") filed an Application with the Arizona Corporation Commission ("Commission") on April 6, 2009, requesting a limited waiver of the Commission Public Utility Holding Companies and Affiliated Interests Rules (A.A.C. R12-2-801 to R12-2-805 ("Rules"), or in the alternative, approval under the Rules; and approval pursuant to A.R.S. § 40-285 to incur additional debt obligations of up to \$500 million and to secure the debt by liens on Applicants' assets. The Application is available for inspection during regular business hours at the office of Applicants' legal counsel, Lewis and Roca LLP, 40 North Central Avenue, Suite 1900, Phoenix, Arizona 85004; at the offices of the Commission located at 1200 West Washington Street, Phoenix, Arizona 85007; and on the Internet via the Commission website (www.azcc.gov) using the e-Docket function.

Intervention in the Commission's proceedings on the Application shall be permitted to any person entitled by law to intervene and having a direct substantial interest in this matter. Persons desiring to intervene must file a Motion to Intervene with the Commission that must be served upon applicant and that, at a minimum, shall contain the following information:

1. The name, address, and telephone number of the proposed intervenor and of any person upon whom service of documents is to be made if different from the intervenor.
2. A short statement of the proposed intervenor's interest in the proceeding.
3. Whether the proposed intervenor desires a formal evidentiary hearing on the Application and the reasons for such a hearing.
4. A statement certifying that a copy of the Motion to Intervene has been mailed to Applicants.